

**State Funding Board
Sewage Treatment Facilities Fund**

**For the Year Ended
June 30, 2001**

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**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY**

State Capitol
Nashville, Tennessee 37243-0260
(615) 741-2501

John G. Morgan
Comptroller

March 26, 2002

The Honorable Don Sunquist, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Members of the State Funding Board
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the State Funding Board, Sewage Treatment Facilities Fund, for the year ended June 30, 2001. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance resulted in no audit findings.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/th
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State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
State Funding Board
Sewage Treatment Facilities Fund
For the Year Ended June 30, 2001

AUDIT OBJECTIVES

The objectives of the audit were to consider the fund's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, and contracts; to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

AUDIT FINDINGS

The audit report contains no findings.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report which contains all findings, recommendations, and management comments, please contact

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**Audit Report
State Funding Board
Sewage Treatment Facilities Fund
For the Year Ended June 30, 2001**

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State Funding Board Sewage Treatment Facilities Fund For the Year Ended June 30, 2001

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the State Funding Board, Sewage Treatment Facilities Fund. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to “perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller.”

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

The Sewage Treatment Facilities Fund has operated since the early 1970s under authority of Section 68-221-202, *Tennessee Code Annotated*. The fund provided financial assistance to local governments and utility districts for the construction of sewage treatment, solid waste recovery, and waterworks facilities. A user’s fee was authorized to generate funds for the borrowing entities to repay the loans. General obligation bonds were sold to finance the program. Although these bonds remain full faith and credit obligations of the state, they are being retired from resources of the fund. Financing for this program is currently generated by the Tennessee Local Development Authority.

ORGANIZATION

The State Funding Board approved contracts for program financing after state environmentalists provided engineering expertise to determine the eligibility and priority of municipal projects. The State Funding Board is composed of the Governor, who serves *ex officio* as chairman; the State Treasurer; the Secretary of State; the Commissioner of Finance and Administration; and the Comptroller of the Treasury, who serves *ex officio* as secretary.

The staff of the State Funding Board is composed of certain employees of the Division of Bond Finance, Office of the Comptroller of the Treasury.

An organization chart for the State Funding Board is on the following page.

AUDIT SCOPE

The audit was limited to the period July 1, 2000, through June 30, 2001, and was conducted in accordance with government auditing standards generally accepted in the United States of America. Financial statements are presented for the year ended June 30, 2001. The State Funding Board, Sewage Treatment Facilities Fund, forms an integral part of state government and as such has been included as an enterprise fund in the *Tennessee Comprehensive Annual Financial Report*.

The audit covered fund 33 of the State of Tennessee Accounting and Reporting System (allotment code 307.07).

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the fund's internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements;
2. to determine compliance with certain provisions of laws, regulations, and contracts;
3. to determine the fairness of the presentation of the financial statements; and
4. to recommend appropriate actions to correct any deficiencies.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

TENNESSEE STATE FUNDING BOARD ORGANIZATION CHART



RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the financial statements of the State Funding Board, Sewage Treatment Facilities Fund, for the year ended June 30, 2001, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by government auditing standards generally accepted in the United States of America. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance

The results of our audit tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the financial statements of the State Funding Board, Sewage Treatment Facilities Fund.



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**Report on Compliance and on Internal Control
Over Financial Reporting Based on an Audit of
Financial Statements Performed in Accordance With
*Government Auditing Standards***

November 16, 2001

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the financial statements of the State Funding Board, Sewage Treatment Facilities Fund, as of and for the year ended June 30, 2001, and have issued our report thereon dated November 16, 2001. As discussed in Note 5 to the financial statements, the fund implemented Governmental Accounting Standards Board Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*. We conducted our audit in accordance with government auditing standards generally accepted in the United States of America.

Compliance

As part of obtaining reasonable assurance about whether the fund's financial statements are free of material misstatement, we performed tests of the fund's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

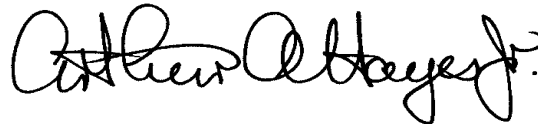
The Honorable John G. Morgan
November 16, 2001
Page Two

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee and management and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,

A handwritten signature in black ink, appearing to read "Arthur A. Hayes Jr.", with a stylized, cursive script.

Arthur A. Hayes, Jr., CPA,
Director

AAH/th



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
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Independent Auditor's Report

November 16, 2001

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying balance sheet of the State Funding Board, Sewage Treatment Facilities Fund, as of June 30, 2001, and the related statements of revenues, expenses, and changes in retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the fund's management. Our responsibility is to express an opinion on these financial statements, based on our audit.

We conducted our audit in accordance with government auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

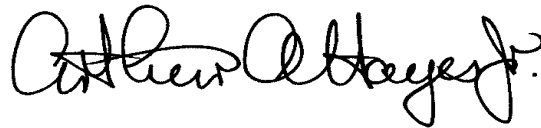
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State Funding Board, Sewage Treatment Facilities Fund, as of June 30, 2001, and the results of its operations and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Honorable John G. Morgan
November 16, 2001
Page Two

As discussed in Note 5 to the financial statements, the fund implemented Governmental Accounting Standards Board Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 16, 2001, on our consideration of the fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

A handwritten signature in black ink, reading "Arthur A. Hayes, Jr." in a cursive script.

Arthur A. Hayes, Jr., CPA,
Director

AAH/th

STATE FUNDING BOARD
SEWAGE TREATMENT FACILITIES FUND
BALANCE SHEET
June 30, 2001

(Expressed in Thousands)

ASSETS

Current assets:

Cash (Note 2)	\$ 3,739
Loans receivable	3,280
Interest receivable on loans	<u>20</u>

Total current assets	<u>7,039</u>
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Other assets:

Loans receivable	14,428
Deferred charges	<u>91</u>

Total other assets	<u>14,519</u>
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Total assets	<u><u>\$ 21,558</u></u>
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LIABILITIES AND EQUITY

Liabilities:

Current liabilities:

Accrued interest payable	\$ 282
Payable to borrowers (Note 3)	464
General obligation bonds payable, net (Note 4)	<u>3,280</u>

Total current liabilities	<u>4,026</u>
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Noncurrent liabilities:

General obligation bonds payable, net (Note 4)	<u>13,933</u>
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Total liabilities	<u>17,959</u>
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Equity:

Retained earnings, unreserved	<u>3,599</u>
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Total liabilities and equity	<u><u>\$ 21,558</u></u>
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The Notes to the Financial Statements are an integral part of this statement.

STATE FUNDING BOARD
SEWAGE TREATMENT FACILITIES FUND
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN RETAINED EARNINGS
FOR THE YEAR ENDED JUNE 30, 2001

(Expressed in Thousands)

OPERATING REVENUES

Revenue from loans	\$ 790
Interest income	<u>255</u>

Total operating revenues	<u>1,045</u>
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OPERATING EXPENSES

Interest expense	943
Subsidy to borrowers	139
Bond issuance costs	10
Administrative expense	<u>11</u>

Total operating expenses	<u>1,103</u>
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Operating loss	<u>(58)</u>
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Nonoperating expense

Payment to Tennessee Local Development Authority	<u>(25)</u>
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Total nonoperating expense	<u>(25)</u>
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Net loss	(83)
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Retained earnings, July 1	<u>3,682</u>
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Retained earnings, June 30	<u><u>\$ 3,599</u></u>
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The Notes to the Financial Statements are an integral part of this statement.

STATE FUNDING BOARD
SEWAGE TREATMENT FACILITIES FUND
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2001

(Expressed in Thousands)

Cash flows from operating activities:	
Payments for interfund services	\$ (11)
Net cash used by operating activities	<u>(11)</u>
Cash flows from noncapital financing activities:	
Principal payments	(3,125)
Interest paid	(1,004)
Subsidy to borrowers	(129)
Payment to Tennessee Local Development Authority	<u>(25)</u>
Net cash used by noncapital financing activities	<u>(4,283)</u>
Cash flows from investing activities:	
Collections of loan principal	3,217
Interest received on loans	771
Interest received on investments	<u>255</u>
Net cash provided by investing activities	<u>4,243</u>
Net decrease in cash	<u>(51)</u>
Cash, July 1	<u>3,790</u>
Cash, June 30	<u><u>\$ 3,739</u></u>
Reconciliation of operating loss to net cash used by operating activities:	
Operating loss	\$ (58)
Adjustments to reconcile operating loss to net cash used by operating activities:	
Amortization	10
Revenue from loans	(790)
Interest income	(255)
Interest expense	943
Subsidy to borrowers	<u>139</u>
Total adjustments	<u>47</u>
Net cash used by operating activities	<u><u>\$ (11)</u></u>

The Notes to the Financial Statements are an integral part of this statement.

State Funding Board
Sewage Treatment Facilities Fund
Notes to the Financial Statements
June 30, 2001

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Sewage Treatment Facilities Fund was created to provide financial assistance to local governments and utility districts through the issuance of state general obligation bonds. The Tennessee Local Development Authority currently generates financing for the program. Pursuant to the Governmental Accounting Standards Board's *Codification of Governmental Accounting and Financial Reporting Standards*, Section 2100, the State Funding Board, Sewage Treatment Facilities Fund, is part of the primary government and has been included in the *Tennessee Comprehensive Annual Financial Report* as an enterprise fund (State Loan Program).

Basis of Presentation

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). The State Funding Board, Sewage Treatment Facilities Fund, follows all applicable GASB pronouncements as well as applicable private sector pronouncements issued on or before November 30, 1989.

Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared using the accrual basis of accounting and the flow of economic resources measurement focus. Under this basis, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred.

Operating revenues and expenses are distinguished from nonoperating items in the Sewage Treatment Facilities Fund. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with principal ongoing operations. The principal operation of the fund is to provide loans to local governments through the issuance of bonds or notes. Therefore, the principal operating revenues of the fund are from loans made to borrowers. The fund also recognizes interest income as an operating revenue. The fund's operating expenses include interest paid on borrowings, subsidies to borrowers, bond issuance costs, and administrative expenses. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

State Funding Board
Sewage Treatment Facilities Fund
Notes to the Financial Statements (Cont.)
June 30, 2001

NOTE 3. PAYABLE TO BORROWERS

This account represents loan principal overpayments and interest earnings that will be refunded to borrowers.

NOTE 4. BONDS PAYABLE

Bonds payable at June 30, 2001, are as follows (expressed in thousands):

	<u>June 30, 2001</u>
General obligation bonds, 5.0%, issued March 1, 1977, due in generally decreasing amounts of principal and interest ranging from \$2.6 million in 2002 to \$0.7 million in 2001	\$ 7,975
Refunding general obligation bonds, 4.6% to 5.0%, issued February 15, 1996, due in various amounts of principal and interest from \$1.6 million in 2002 to \$1.0 million in 2010 (net of unamortized premium of \$251 and deferred amount on refunding of \$173 at June 30, 2001)	<u>9,238</u>
Total bonds payable	<u>\$ 17,213</u>

Debt service requirements to maturity for all bonds payable at June 30, 2001, are as follows (expressed in thousands):

<u>For the Year(s)</u> <u>Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2002	\$ 3,280	\$ 848	\$ 4,128
2003	2,845	684	3,529
2004	2,990	542	3,532
2005	2,830	392	3,222
2006	1,645	251	1,896
2007-2010	<u>3,545</u>	<u>434</u>	<u>3,979</u>
Total	<u>\$ 17,135</u>	<u>\$ 3,151</u>	<u>\$ 20,286</u>

State Funding Board
Sewage Treatment Facilities Fund
Notes to the Financial Statements (Cont.)
June 30, 2001

NOTE 5. CHANGE IN ACCOUNTING PRINCIPLE

As of July 1, 2000, GASB No. 33, Accounting and Financial Reporting for Nonexchange Transactions, was implemented for the fund. Certain interest earnings of the fund that are credited to the borrowers are considered voluntary nonexchange transactions. Prior to the implementation of GASB No. 33, these amounts were reported as a reduction of revenue from loans in the financial statements. With the implementation of GASB No. 33, these amounts are reported as an expense – Subsidy to borrowers.

In addition, the implementation of GASB No. 33 affected the reporting of transfers between the primary government and component units. Transfers between the primary government and a component unit are considered voluntary nonexchange transactions. Prior to the implementation of GASB No. 33, these transfers were reported as operating transfers on the Statement of Revenues, Expenses, and Changes in Retained Earnings. With the implementation of GASB No. 33, these transfers are reported as nonoperating revenues or expenses.